Is there a need for supply-side management measures in the EU-ETS?

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What is the EU-ETS for?

- “This Directive will encourage the use of more energy-efficient technologies” (Oct 2003)

- The Commission assesses the second period plans in a manner which ensures (...) sufficient scarcity of allowances in the EU ET, thereby in turn ensuring that emissions reductions are delivered and that the emerging carbon market is strengthened.” (Nov 2006)

- “The Commission mainly requires changes where: (...) the proposed cap is not consistent with the Member State’s expected emissions and its technological potential to reduce these” (Mar 2007)

- “Contributing to transforming Europe into a low greenhouse-gas-emitting economy and creating the right incentives for forward-looking, low-carbon investment decisions by reinforcing a clear, undistorted and long-term carbon-price signal.” (Jan 2008)

- “The European Council, held on 8-9 March 2007 in Brussels, endorsed these objectives. It also acknowledged the central role of emissions trading in the EU's long-term strategy for reducing greenhouse gas emissions” and underlined that the European Union Emissions Trading System (EU ETS) is and will remain one of the most important instruments for the EU’s contribution towards achieving the significant emissions reductions which are necessary to meet the strategic objective of limiting the global average temperature increase to not more than 2 degrees C above pre-industrial levels.” (Jan 2008)

- “(...) ensuring that the emissions trading system delivers gradual and predictable reductions of emissions over time” (Dec 2008)

- “As the primary tool to drive emission reductions, the ETS should be the starting point for options for going beyond 20%” (May 2010)

(Source: European Commission)

The EU-ETS is the spearhead of EU climate policy

=> the objectives that underpin it transcend EU climate targets alone:

(i) reducing EU GHG emissions by at least 20%/1990 levels by 2020
(ii) promoting CCS such that it becomes commercially viable by 2020
(iii) fostering a genuinely global carbon market
Upward Risks to EUAs supply. Do we need to do something?

Upward risks to our estimates for the supply of EUAs

- **NAP-2 legal cases**
  Ongoing Phase-2 NAPs legal cases that could end up in our worst-case scenario with 110m additional EUAs

- **Aviation**
  Strong opposition from third countries.
  Growing likelihood of the Commission and MSs using the exemption provision that was originally established in article 25a of the Aviation Directive

- **Recession?**
  The risk of a further material deterioration in EU sovereign debt and inter-bank lending markets

- **Energy Efficiency**
  In June the Commission proposed far-reaching measures to allow achieving the 2020 target and floated the idea of setting mandatory targets in the future if insufficient measures are developed by Member States.

=> Downward pressure on prices

The rationale for supply-side measures

- Re-establishing the supply-demand balance for Phase 3 of the EU-ETS that it originally envisaged when it published the ETS review
- Unlike other commodities markets, the supply of EUAs is fixed many years in advance
- Make up for emission reductions to come from complementary measures
- Reinforce the carbon-price signal (price trend)
- Reinforce confidence in EU-ETS institutions
- Reinforce predictability: predictability is not necessarily achieved via an arbitrary fixed cap; could be achieved by a certain level of prices long term.

=> Need for supply-side management measures
What could we do?

Main options to support prices
- Reducing the long-term linear reduction factor in the EU-ETS
- Setting a price floor/ceiling for Phase-3 auctions (beyond 2020?)
- Increasing the EU-wide 2020 emission-reduction target (beyond 2020?)
- Setting aside allowances from the pot of allowances to be auctioned in Phase-3
- Creating a carbon Central Bank

The idea of a set-aside
Above and beyond increasing the 2020 EU-wide emission-reduction target, the idea of a set-aside has been floated. However, it might not be the panacea.
- Would it be legally feasible?
- Is a set-aside desirable?

In the end, as far as Phase-3 is concerned, the regulatory lead-time will dictate the tool to be chosen.

Supply-side management measures could also help in redispersing EUAs supply over a given period, thus avoiding today’s surplus dampening prices, although the scheme will likely be short EUAs by 2020.
Appendix 1
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Additional Information Available upon Request

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